CAPITAL INADEQUACY

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(1) Introduction

"Capital Adequacy" sounds a very content scenario. The phrase gives an impression of satisfaction and fulfillment; being adequate suggests that a major issue is over. How adequate is capital adequacy? Does it really bring about the results desired by the depositors, regulators and the bankers? Is there anything called adequate capital ? Isn't more better ? Wouldn't less be enough? The purpose of this article is to highlight the limitations of a single factor performance/strength measurement that can give a misleading message, "Everything is alright !". The article looks at the role of capital, its relationship to bank failures, preventive role and "cure" that capital can offer, matters "beyond capital" and related issues.

(2) The Role of Capital in a Bank

What role does capital play in a bank? The role of capital can be identified broadly in the following lines:

1) Capital provides the funds required to set up (and expand) the bank by meeting the fixed capital requirements.

2) Capital provides a means of absorbing temporary losses or set backs encountered by the bank.

3) Capital provides solvency, i.e. ability to meet all the liabilities at the time of dissolution / winding up of the bank.

Capital Adequacy of a bank has become an important topic in terms of the second and third items listed above. The importance of capital in the banking system is viewed with emphasis on its ability to absorb losses arising from undertaking a variety of risks and also with regard to its role as a provider of solvency.

2.1 The Role of Capital in absorbing Losses / Set backs.

Banks take a variety of risks in running their day to day operations. These risks can lead to gains or losses. Therefore the assumption of risks is followed by the potential for gains or losses. If risks consistently provide gains only, then it is well and good. However, if risks lead to losses, then the bank must have the ability to meet the losses. The availability of capital meets losses in two ways :

a). When explicit losses are incurred, such losses may be partly or fully financed by the earnings attributable to the equity holders. The result is a reduction of profits. Should there be sufficient equity capital, there is likely to be adequate profits attributable to shareholders prior to charging those losses arising from crystallization of risks.

b). If the adverse effects of the risks are substantial and hence if the losses are significant, then the losses might exceed the current year earnings. The result is that there should be a source of funding of the losses. Capital performs this role of meeting such losses.

2.2 What are the Main Risks faced by a Bank ?

A bank assumes a large variety of risks. Of all these, it is possible to identify three broad categories of risks :

(1) Credit Risk

This is the risk of default by the borrowers of the bank. This probably is the single most significant risk that a bank may assume if it is operating under a typical banking model.

(2) Market Risk

This is the risk of losses arising from changes in the market prices including exchange rates and interest rates. The key types of risks that may be classified under this heading are :

1) Interest Rate Risk
2) Foreign Currency Risk
3) Equity Risk
4) Commodity Price Risk (if applicable)

Operational Risk is defined in the document titled“ International Convergence of Capital Measurement and Capital Standards; A Revised Framework” more popularity known as Basel II, produced by the Basel Committee on Banking Supervision, and published by the Bank for International Settlements, in June 2004.

“Operational Risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk but excludes strategic and reputational risk”.

(3) The Role of Capital in Providing Solvency

If a bank fails , despite all capital requirements, regulations, supervision etc., what would be the fate of the depositor ? The answer to this question depends on two aspects :

(1) The realisability of the assets and, in particular, the recoverability of the credit facilities extended.

(2) The proportion of funding of such assets by the depositors and the providers of capital.

The first is an issue of “asset quality” and, of course, higher the asset quality - higher the ability to pay the depositors; hence higher the solvency.

The second item is the adequacy of capital in funding the assets. If, in a hypothetical scenario,

all the assets are funded by depositors, then it is obvious that, as only a certain percentage of assets can be realized into cash, the depositors will lose a portion of their deposits.

If, on the other hand, a certain portion of the funding comes by way of capital funds which are subordinated to the depositors' claim, then it is likely that the depositors will receive either full deposit value or at least a higher percentage of the claim than in the previous scenario.

To illustrate this, let us take a bank that has assets of Rs. 100 Bn Suppose the bank fails and only Rs.70 Bn can be realized in cash. Take two scenarios of the liability side. First scenario is where 100% is funded by deposits. In this case, of the deposits of Rs.100 Bn only, Rs. 70 Bn can be repaid i.e. 70% of deposits.

The second scenario is where, let us assume, the assets are funded by Rs.80 Bn of deposits and Rs. 20 Bn of Capital funds. Since Capital funds are subordinated to the depositors' claim, depositors will be paid first. They will receive Rs.70 Bn which is the total amount realized. This works out to Rs.70 Bn out of Rs.80 Bn which is 87.5% of deposits; a big improvement.

It can be clearly seen that the asset quality as well as the proportion of capital (capital adequacy) both play a vital role in providing solvency.

(4) Restructure or Close down? What is the Better way to Safeguard Depositors?

The illustration in the previous paragraph was on the basis of liquidation of the bank concerned realizing the assets i.e. mainly recovering the loans granted, after the failure of the bank.

However, liquidation or closing down is found to be the least effective way of safeguarding the interest of the depositors. The most obvious reason is that the credit facilities granted by a bank to an on going business cannot be demanded for repayment simply because the bank has come to a standstill. While the bank ceases to be a going concern, the borrowers are yet going concerns. They will demand revolving banking facilities and longer repayment programmes as previously scheduled. If not, alternative banking facilities should be arranged by transfer of the facilities to some other bank/s, may be at discounted values. Instead, if the facilities are called up for immediate repayment the recoverability will be very poor. This is against the best interest of the depositors. On the other hand, if a liquidator takes a long time & allows the repayment of debts over a period of time, there will be heavy administrative overheads that will eat into the sums recovered. In this case too, the amount available to the depositors will be adversely affected.

Therefore, it is necessary that a regulatory authority, charged with the duty of taking over a bank upon failure, acts fast and also acts in a restructuring approach rather than resorting to liquidation.

There are different alternative methods / approaches available to an authority to deal with a failed bank using a restructuring approach :

1) Permit another bank to take over the failed bank while retaining the identity and license of the failed bank. This could probably be in a situation where the failed bank is yet found to

have potential to revive.

2) Permit another bank to absorb the failed bank. The deposit liabilities are assumed by the acquiring bank and the assets are transferred. The transfer value of the assets, i.e. the extent of discount, will depend on the asset quality.

If there is a gap between the discounted value of assets that are identified for transfer and the amount of deposit liabilities, then somebody must bridge the gap. Different options are available:

1) Capital funds would have already absorbed part of the loss & reduced the gap.

2) A deposit insurance agency, if one had existed and covered the deposits, would meet the difference.

3) A Government Authority will meet the difference on an exceptional basis, through a grant. (Examples are available in the Japanese banking system).

4) The gap can be passed on to the depositors by compelling them to accept the relevant percentage after reducing the gap as the new value of the deposits, since depositors anyway have not much choice.

5) A part of the deposits can be converted into risk capital in either of a number of forms such as :

1) Non interest bearing long term debt
2) Deep discount subordinated debentures
3) Preference Shares
4) Non Voting Shares or
5) Ordinary Shares

In either of the two approaches suggested above and under different options in the second approach, it is likely that the depositors will receive a higher percentage of their deposits than on an outright liquidation or winding up of the failed bank.

This forms my first contention of Capital inadequacy. While capital adequacy may reduce the extent of losses to depositors, the authorities can bring about a major impact and thereby significant changes to the percentage of deposit funds realized by the depositors, simply by using a forward looking and positive restructuring approach instead of a backward looking negative approach of winding up.

(5) Bank Failures in the United Sates of America (USA) and the FDIC.

USA had encountered a large number of bank failures probably in line with the large number of small banks operating as unit banks, with a single office or few branches.

The Federal Deposit Insurance Corporation (FDIC) is the US Government agency charged with the duty of promoting stability in the financial system and also providing deposit insurance. It is an independent agency created by the US Congress in 1933. FDIC supervises banks and insures deposits up to USD100,000/ - and helps maintain a stable and sound banking system. The deposit insurance is voluntary. The FDIC insures banks and Savings Associations.

FDIC proudly claims that not a single depositor has lost a penny out of their insured deposits up to USD 100,000/- since 1934.

5.1 Failure Resolution Approaches of the FDIC

FDIC has had 3596 insured bank failures to deal with since 1934. The depositors are paid or assured payment almost immediately while FDIC will pursue different approaches to resolve the failure. There are three broad categories and sub categories defined within the three categories.

Category I : **In this category the FDIC attempts to revive the failed bank, while FDIC will provide assistance to overcome the failures. The License & identity of the failed bank remains.**

Category II : **In this category the assets and liabilities are transferred to FDIC or another bank. One method is to place the failed bank under the control of a Government agency until it is revived.**

Both category I and II appear to be approaches to maintain the going concern nature of the failed bank and to restructure and revive the business.

Category III : **This is to pay off the depositors and liquidate the bank. Of the 3596 failures, FDIC, having paid the insured deposits, has concluded 2011 transaction of finalizing the affairs of the failed banks. The difference of 1585 instances relate to transaction pending conclusion.**

Please refer Annex 1 for a detailed schedule.

5.2 The Concentration of Bank Failures to "Failure Eras"

It should be noted that there were two eras of bank failures in the USA. The 1st era was 1934 to 1942 where 402 banks had failed. (banks include savings associations). The second era of a large number of failures was between 1980 and 1994. There were a massive 2936 bank failures during this 14 year period. Therefore, of the 3596 failures, 3,338 failures belong to the two specified eras. In other words, of the 70 years period between 1934 and 2004, 3338 out of 3596 failures had occurred during two eras totalling to 22 years. This is to say that 92.8% of the failures have occurred during 31.4% of the total time period.

5.3 What does such Concentration of Bank Failures Imply ?

Bank failure is not simply an internal matter. Bank failures are significantly affected by the external economic environment. They could also be contagious. Did all the 2936 banks that

failed during the 14 years period of 1980 – 1994 fail because of capital adequacy issues ? It is unlikely.

These lead to my second contention of "Capital inadequacy". While capital does play a vital role, the external economic shocks on a bank cannot be undermined.

5.4 Is There a Role of Contractionary Monetary Policy on Bank Failures in USA ?

An attempt was made to establish a relationship between bank failures and key economic indicators such as GDP, GDP growth, Money supply, consumer price indices and rate of inflation. It was found that it was difficult to establish a clear relationship between the level of GDP or GDP growth and the intensity of bank failures in the USA.

However, there was a medium level negative correlation (r), (r = - 0.5041), between the level of money supply (M3) and the intensity of bank failures, in the USA during the period 1980 - 2004 (r = - 0.599 for the period 1986 to 2004). It is of course pre-mature to come to a conclusion that contractionary monetary policy where the growth of the money stock had been slowed down, had an adverse impact on the banks leading to failures.

The following graphs indicating number of bank failures and the percentage growth of money supply (M3) also show a somewhat strong negative relationship. (It is left for further research to establish a relationship and also justify the causation of one by the other). One could, of course, argue that slowing down of the monetary growth affects both the main end products of a bank viz deposits and advances. When growth of both these is restricted the banks will have to control their own growth. With a restricted growth of business they invariably will have to control the growth of overheads. If not, the bank will have poor or negative earnings.

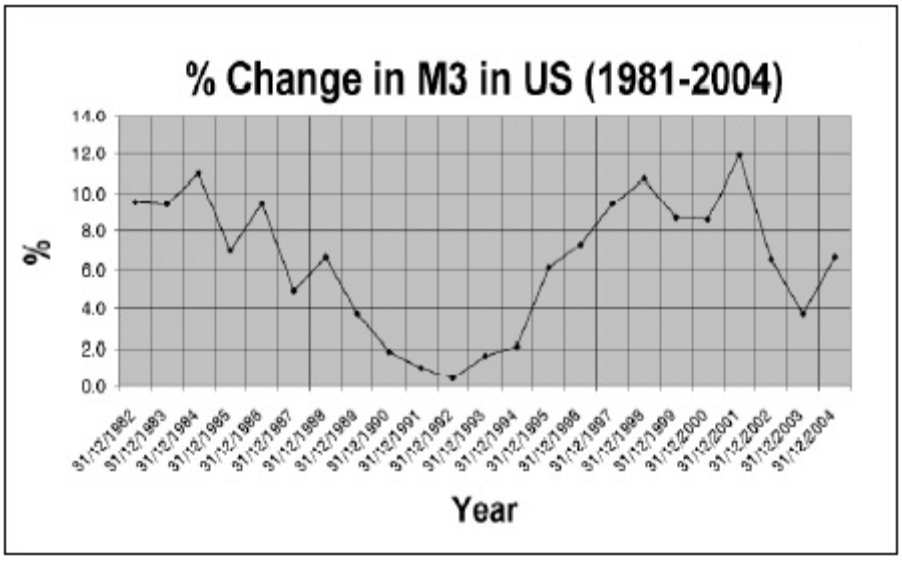
Controlling overhead costs is easier said than done. Hence, the banks will have to service increasing overheads with restricted growth of business under a prolonged period of low monetary growth. Would banks fail due to this reason?

Another possible reason is that under restricted growth of credit, the businesses will find it difficult to grow and sustain financial performance. Could there be an increase in default rates leading to poor asset quality and bank failures?

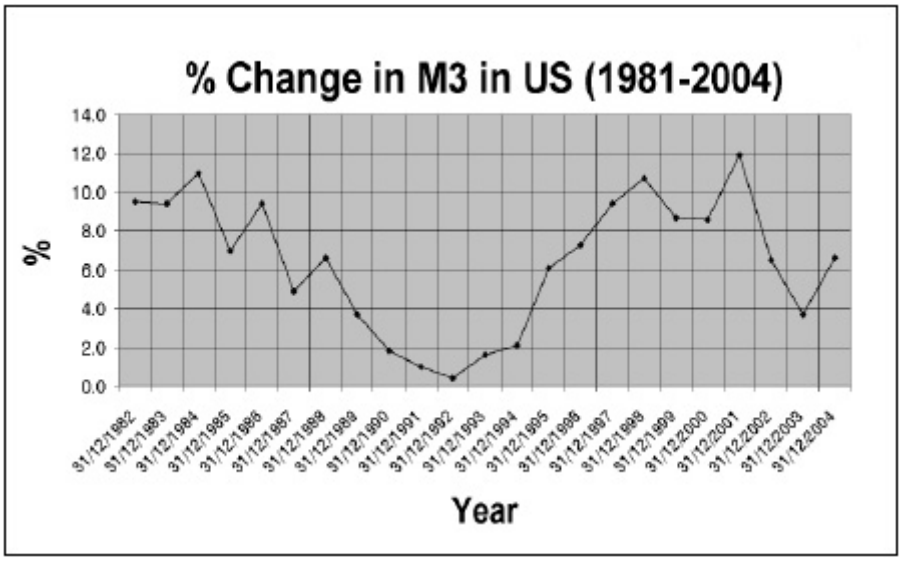
Can restrictive monetary policy create severe pressure particularly on the smaller and weaker banks in maintaining liquidity; hence liquidity problems that lead to failure? Attempting to grow credit portfolios at a rate higher than the overall restricted growth rate will lead to liquidity constraints in the system.

Could the negative relationship between the growth rate of money supply and the number of bank failures be as a result of the bank failures causing the slower growth of money supply instead of the slower growth of money supply causing the bank failures? Or is there no relationship at all but a co-incidental pattern?

More research will be necessary to address these issues.



Graph (1) Number of Bank failures year by year, in USA, 1980 - 2004
Source: Federal Deposit Insurance Corporation, FDIC, USA



Graph (2) The percentage change in money supply (M3) in USA during the period 1981 - 2004 based on closest year end point to point figures.
Source: (M3 Values) Federeal Reserve Bank
http://research.stlouisfed.org/ publications/usfd/

(6) The Basel II Logic of Capital Inadequacy.

Basel II is the most authoritative source of confirmation that the role of capital as the sole means of banking and financial system stability, has been challenged.

Basel II proposes a 'three pillar' approach.

- **The First Pillar is the Minimum Capital Requirements**

Under this, there are comprehensive guidelines on the methods to be adopted in determining the minimum capital required to be held with particular emphasis on credit risk and operational risk.

The Second Pillar is the Supervisory Review Process

Four key principles for supervisory review are proposed in the document. The whole idea is to place much importance on the supervisory review process, a step beyond capital adequacy.

The Third Pillar is the Market Discipline.

Under this pillar, emphasis is made on the disclosure requirements and need to achieve adequate disclosure. It is presumed that adequate disclosures will enable the public to make assessments on the strengths & stability of banks. Further, improved disclosures will also compel the banks to address the underlying issues, as matters of priority.

(7) Non Capital Factors that Support Banking Stability – Beyond "CAMEL"

A common model used to identify a balanced set of factors that are important for the stability of a bank is known by the acronym CAMEL.

C - Capital Adequacy
A - Asset Quality
M - Management
E - Earnings
L – Liquidity

A further analysis of these aspects, which are undisputed and well recognized as factors that bring about stability and strength to a bank, is not being pursued. Instead, the endeavour is to expand on the model to identify several internal and external factors that are important for the soundness and stability of a bank. In identifying these factors, it is proposed that it is not necessary to confine to the economic and financial market inputs. Banks can be viewed as business organizations and some of the factors that lead to the failure of business organizations can equally lead to failure of banks.

7.1 External Factors that may Trigger Bank Failures

Some of the important external factors that may trigger failures are broadly identified below: The list is not, by any means, exhaustive.

1. Severe Competition in the Industry

Like in any other industry, severe competition must lead to some banks being compelled to exit for the survival of the rest.

2. Exchange Crisis

An exchange crisis (currency crisis) can trigger a banking crisis. Banks are the gateway for

economic crisis to enter and exit the economies. In the process, the banks' Balance Sheets get affected. Banks' customers too will get affected in a currency crisis and that in turn will lead to nonperforming assets leading to eventual failures.

3. Banking Crisis

A banking crisis, per se, once triggered can lead to further failures. Examples of banking failures in the United States were discussed in a previous paragraph. Such failures were despite deposit insurance where depositors (at least the large number of small depositors) would not have any reason to panic. In an environment where the banks have not subscribed to a deposit insurance scheme the sensitivity could be higher.

4. Failure of Real Estate Market/"A Burst of a Bubble"

Rapidly rising property prices under an economic boom can plant time bombs that explode after a delay. When property prices rise the potential borrowers get the ability to offer more collateral (same properties would be worth more) and be able to borrow more. Further, there would be increased borrowings to finance the real estate projects themselves. After reaching a particular point the economy may have excess capacity in properties and the property market could collapse. The property market could also collapse due to a slowing down of the economy. The failure of this segment will leave the banks with poor collateral on facilities granted and hence, coupled with a economic recession, non recoverable advances.

5. Monetary Policy Implications

As discussed earlier, persistent contractionary monetary policy can lead to instability in the banks. In addition to the effects on growth and liquidity, there will also be adverse effects from rapidly rising interest rates.

Banks typically carry long-term assets funded by short-term liabilities. It is a fact. This is particularly so because most of the customer advances tend to be for periods over 3 months whereas the most common deposits in the form of current and savings accounts are payable on demand. It is easy for a bank to benefit from a reduction of interest rates where short-term liabilities get re-priced immediately while the long-term assets tend to carry the same high rates until they are re-priced.

In contrast, a bank will have to meet an immediate increase in interest cost without an increase in revenue, when interest rates go up while the bank carries a long position.

A sudden increase in interest rates to a high level will also weaken the financial performance of the borrowers, which in turn will affect the banks.

6. Regulatory Interventions

Intervention of a regulatory authority without adequate legal backing and a range of tools to overcome failure can in fact trigger failure. For example, in the Sri Lankan legal framework, one of the first steps available to the regulator is to "suspend the license" to carry on the

banking business. This is probably the last step in a comprehensive framework. Different arrangement made by FDIC of USA under three categories were discussed earlier.

7. Poor Legal Framework

Banks engage in the business of lending money. If borrowers do not repay, the banks suffer losses. There are willful defaulters who have the ability to repay but not the willingness. Banks should be in a position to pursue legal action and recover dues on the merit of the transactions and not on the technical details that may be filed in a Court of Law. A poor legal system with pro-longed court cases will weaken the debt recovery process and hence the stability of the banks.

7.2 Internal Factors that may Lead to bank Failures.

Let us identify some key internal factors, again the list not being exhaustive.

1. Management Quality and commitment

Like in the case of any business organization, Management plays a vital role in a bank. It is the management that can decide the destiny and fate of the bank in most instances. Failure on the part of the management will invariably lead to failure of the bank.

2. Size of the Bank

Does the size of the bank matter ?

Rightly or wrongly, banks that have reached a certain qualifying size seem to benefit from economies of scale, pooling of risk and diversification. They also will have a bigger economic impact in the event of a failure and hence tend to get more support to avoid failure rather than being “pushed towards” failure.

3. Capital Structure

As much as the capital base, the capital structure of a bank is important. If the capital base comprises more of interest bearing ‘debt capital’ then the bank would be of relatively higher gearing. This increases the financial risk and reduces the financial strength.

4. Not adequately “Pooling” Risk

Banks pool risk by lending to a large number of borrowers. It is a kind of an insurance. No one loan would be large enough to destabilize the bank. If, however, a bank ignores this principle of “Pooling” and place reliance on few large borrowers, then the failure of few borrowers can lead to the failure of the bank.

5. Lack of Diversification of Lending.

A bank that concentrates on a couple of sectors in the economy may be adversely affected by failure of such sectors. Having a well diversified portfolio of advances will bring in stability to a bank.

6. Reckless Lending

One of the single most important contributory factors for bank failures has been poor quality of advances. When advances are non recoverable, the bank encounters failure.

7. Unsustainable Growth

Some banks fail because they engage in a growth process that cannot be sustained. The overtrading problems that banks attribute to their borrowers are equally applicable to the banks themselves. In a battle to capture market share, a bank may expand its deposit base and the advances base aggressively. In this process, it could lower/relax its lending criteria. Further, the growth may not be supported by the internal systems, procedures, human resources, organizational knowledge and adequate financial resources. The result could be an eventual failure.

The Asset Quality – Growth Trap

Banks tend to get into a dilemma in reconciling the growth objectives and the need for the maintenance of asset quality. Further, once trapped in a low quality asset portfolio, high growth tends to be the only way to sustain earnings. Such high growth in turn could be through the acquisition of low quality assets with a view to sustaining short-term profitability. This creates a viscous cycle and the bank will find it difficult to get out of the trap.

Asset Quality – Growth Dilemma

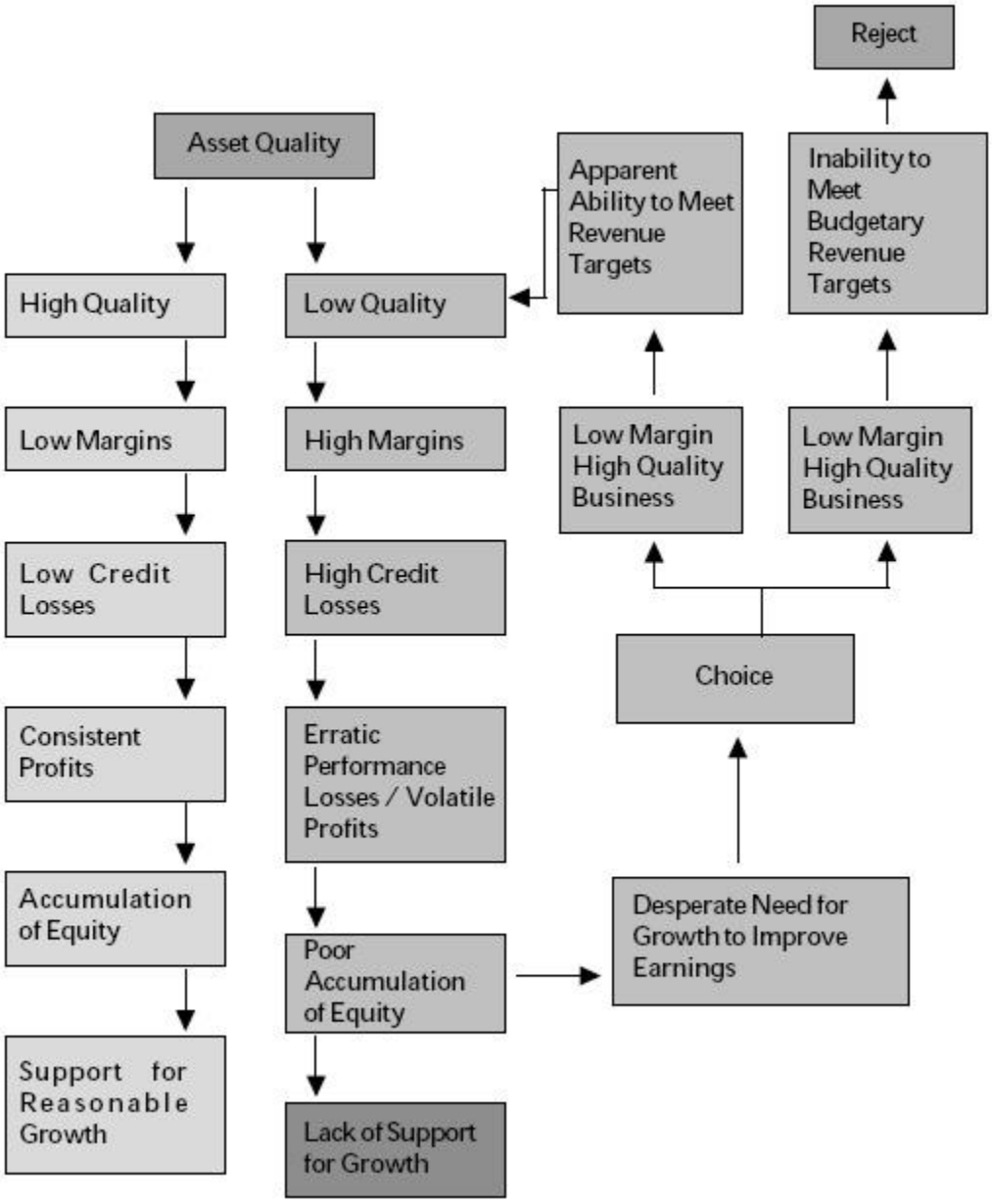


Diagram (1): The Asset Quality - Growth Dilemma faced by a bank with poor asset quality.

8. Degree of Operating Leverage

The degree of operating leverage refers to the extent to which the bank has relied on fixed overheads in its cost structure. Heavy reliance adds to operating leverage while low reliance reduces such leverage. A bank with high fixed overheads is more vulnerable to changes in the net income arising from loss of margins or volumes. Hence, managing the cost structure is important. Particularly, it is necessary to remove unnecessary fixed overheads incurred in non-core banking activities.

9. Profitability

Like in the case of any other business organization, sustained profitability is an important aspect that leads to stability of a bank. Volatile earnings affect the ability to grow and also will lead to loss of confidence and hence a premium added to the cost of funds.

10. Not Managing liquidity

A bank ought to manage liquidity at the desired levels having satisfied the regulatory minimum requirements. Loss of liquidity and the resultant inability to meet the customer demand for withdrawals, even if it happens only at a branch office, can lead to a severe loss of confidence and the panic driven customers may rally round to get the deposits back before the bank fails. This in turn leads to a "bank run".

11. Loss of Customer Confidence

Similar to the scenario in the previous paragraph, loss of customer confidence, due to factors such as adverse disclosures may lead to a 'bank run' or a gradual shrinkage of the volumes.

12. Poor Risk Management

A bank ought to place emphasis on proper systems and procedures for managing risks. It should pay particular attention to credit risk and liquidity risk. It should manage the interest rate risk and foreign exchange risk as two other key risks that keep the bank exposed. In addition, proper operational guidelines and procedures will ensure minimizing the operational risk.

(8) Conclusion

Capital Adequacy is an important aspect for the stability of a bank. However, bank failures are not entirely attributed to this aspect. Hence there is a problem i.e. "Inadequacy of capital adequacy" to prevent bank failures. Basel II recognizes this by identifying three pillars of the framework where minimum capital requirement is all but just one pillar out of the three. There are many important aspects that are preconditions to prevent bank failures. Historical information suggests that there have been concentrated periods of large numbers of bank failures. This proves the impact of external influence on bank failures. Having encountered a failure, the extent to which the depositors' interest would be safeguarded will depend on the approach used by the authorities to resolve the issue. A forward looking restructuring based solution is more appropriate.

References

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Framework" more popularity known as Basel II, produced by the Basel Committee on Banking Supervision, and published by the Bank for International Settlements, in June 2004.

Annex 1
Federal Deposit Insurance Corporation, FDIC, USA
Table BF02
CLOSINGS AND ASSISTANCE TRANSACTIONS
Number of Institutions
United States and Other Areas
1934 - 2004

Year	Total	Ins. Fund		Transaction Types						
	Institutions	BIF	SAIF	A/A	REP	RO	P&A	IDT	MGR	PO
2004	4	3	1	0	0	0	0	0	0	1
2003	3	3	0	0	0	0	0	0	0	0
2002	11	10	1	0	0	0	0	0	0	4
2001	4	3	1	0	0	0	1	0	0	0
2000	7	6	1	0	0	0	0	0	0	0
1999	8	7	1	0	0	0	0	0	0	0
1998	3	3	0	0	0	0	0	0	0	0
1997	1	1	0	0	0	0	0	0	0	0
1996	6	5	1	0	0	0	0	0	0	0
1995	8	6	2	0	0	0	0	1	0	0
1994	15	13	2	0	0	0	0	2	0	0
1993	50	41	9	0	0	0	0	0	0	8
1992	181	122	59	2	0	0	0	13	0	12
1991	271	127	144	3	0	0	0	18	0	9
1990	382	169	213	1	0	0	0	46	0	44
1989	534	207	327	3	1	0	43	140	0	71
1988	470	280	190	238	0	0	0	43	17	7
1987	263	203	59	45	0	0	0	55	14	15
1986	204	145	59	42	0	0	0	33	6	25
1985	180	120	60	41	0	0	0	26	0	26
1984	106	80	26	23	0	0	62	16	0	5
1983	99	48	51	49	0	0	35	8	0	7
1982	119	42	77	85	1	0	25	0	0	8
1981	40	10	30	31	1	0	5	0	0	3
1980	22	11	11	12	0	0	7	0	0	3
1979	10	10	0	0	0	0	7	0	0	3
1978	7	7	0	0	0	0	6	0	0	1
1977	6	6	0	1	0	0	5	0	0	0
1976	17	17	0	1	0	0	13	0	0	3
1975	13	13	0	0	0	0	10	0	0	3

1974	4	4	0	1	0	0	3	0	0	0
1973	6	6	0	0	0	0	3	0	0	3
1972	2	2	0	1	0	0	0	0	0	1
1971	7	7	0	1	0	0	1	0	0	5
1970	7	7	0	0	0	0	3	0	0	4
1969	10	9	0	0	0	0	5	0	0	4
1968	4	3	0	0	0	0	3	0	0	0
1967	5	4	0	0	0	0	0	0	0	4
1966	8	7	0	0	0	0	6	0	0	1
1965	6	5	0	0	0	0	2	0	0	3
1964	8	7	0	0	0	0	0	0	0	7
1963	3	2	0	0	0	0	0	0	0	2
1962	2	1	0	0	0	0	1	0	0	0
1961	6	5	0	0	0	0	0	0	0	5
1960	2	1	0	0	0	0	0	0	0	1
1959	4	3	0	0	0	0	0	0	0	3
1958	5	4	0	0	0	0	1	0	0	3
1957	3	2	0	0	0	1	0	0	0	1
1956	3	2	0	0	0	0	1	0	0	1
1955	6	5	0	0	0	0	1	0	0	4
1954	3	2	0	0	0	0	2	0	0	0
1953	5	4	0	0	0	2	2	0	0	0
1952	4	3	0	0	0	0	3	0	0	0
1951	3	2	0	0	0	0	2	0	0	0
1950	5	4	0	0	0	0	4	0	0	0
1949	6	5	0	0	0	0	5	0	0	0
1948	4	3	0	0	0	0	3	0	0	0
1947	6	5	0	0	0	0	5	0	0	0
1946	2	1	0	0	0	0	1	0	0	0
1945	2	1	0	0	0	0	1	0	0	0
1944	3	2	0	0	0	0	1	0	0	1
1943	6	5	0	0	0	0	1	0	0	4
1942	21	20	0	0	0	0	14	0	0	6
1941	16	15	0	0	0	0	7	0	0	8
1940	44	43	0	0	0	0	24	0	0	19
1939	61	60	0	0	0	0	28	0	0	32
1938	75	74	0	0	0	0	24	0	0	50
1937	78	77	0	0	0	1	26	0	0	50
1936	70	69	0	0	0	0	27	0	0	42
1935	27	26	0	0	0	1	1	0	0	24
1934	10	9	0	0	0	0	0	0	0	9

TransactionTypes

Failing institutions have been resolved through several different types of transactions. The transaction types outlined below can be grouped into three general categories, based upon the method employed to protect insured depositors and how each transaction affects a failed institution's charter. In most assistance transactions, insured and uninsured depositors are protected, the failed institution remains open and its charter survives the resolution process.

In purchase and assumption transactions, the failed institution's insured deposits are transferred to a successor institution, and its charter is closed. In most of these transactions, additional liabilities and assets are also transferred to the successor institution. In payoff transactions, the deposit insurer - the FDIC or the former Federal Savings and Loan Insurance Corporation - pays insured depositors, the failed institution's charter is closed, and there is no successor institution. For a more complete description of resolution transactions and the FDIC's receivership activities, see Managing the Crisis: The FDIC and RTC Experience, an historical study prepared by the FDIC's Division of Resolutions and Receiverships. Copies are available from the FDIC's Public Information Center.

Category 1	Failed institution's charter survives	
	A/A	Assistance Transaction, includes 13(c) and FAM
	REP	Reprivatization
	RO	Institution closed and reopened
Category 2	Failed institution's charter is terminated, insured deposits plus some assets and other liabilities are transferred to a successor charter	
	P&A	Purchase of assets and assumption of liabilities of a failed institution
	IDT	Transfer or assumption of insured deposits of a failed institution
	MGR	Failed institution was placed under government control through FSLIC's Management Consignment Program, then transferred to the Resolution Trust Corporation's conservatorship program after creation of RTC in 1989
Category 3	PO	Payoff of insured deposits, remaining liabilities and assets are liquidateSource: Federal Deposit Insurance Corporation, USA

Annex 2
The Bank Failures and Growth of Money supply in USA, 1981 - 2004

Year	No. of Bank Failures	% change in M3
31/12/1980	22	
31/12/1981	40	
31/12/1982	119	9.5
31/12/1983	99	9.4
31/12/1984	106	11.0
31/12/1985	180	7.0
31/12/1986	204	9.4
31/12/1987	263	4.9
31/12/1988	470	6.6
31/12/1989	534	3.7
31/12/1990	382	1.8
31/12/1991	271	1.0
31/12/1992	181	0.4
31/12/1993	50	1.6
31/12/1994	15	2.1
31/12/1995	8	6.1
31/12/1996	6	7.3
31/12/1997	1	9.4
31/12/1998	3	10.7
31/12/1999	8	8.7
31/12/2000	7	8.6
31/12/2001	4	11.9
31/12/2002	11	6.5
31/12/2003	3	3.7
31/12/2004	4	6.6

Sources: Federal Deposit Insurance Corporation, FDIC, USA, website
Federal Reserve Statistical Release, web site

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